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In The

Supreme Court of the United States

OCTOBER TERM, 1970

No. ~~1780~~ 70-236

ESTATE OF LILLIE Mac MUNN STEWART, deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

EDWIN M. DOTTEN, JR.
HARTLAUB, BRAUN, THORN,
DOTTEN & SKIDMORE
Attorney for Petitioner
57 Union Place
Summit, New Jersey 07901

Of Counsel
LEMUEL SKIDMORE

(4020) LUTZ APPELLATE PRINTERS, INC.
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No.

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W. ALAN HENDERSON, Executor,

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Estate of Lillie MacMunn Stewart, Deceased, W. Alan Henderson, Executor, Petitioner, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit entered in this proceeding on January 5, 1971.

Opinions Below

The opinion of the Court of Appeals for the Third Circuit (3a)[1] reported in 436 F.2d, 1281 (3rd Cir. 1971); the order of that Court denying petitioner's petition for rehearing (1a) and the opinion of the Tax Court (21a), reported in 52 T.C. 830 (1969), appear in the Appendix hereto.

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1. All references herein designated "a" are to pages in the Appendices hereto and all designated "R" are to the certified Record.

Jurisdiction

The judgment of the Court of Appeals for the Third Circuit was entered on January 5, 1971. A motion permitting petitioner to file a petition for rehearing out of time was granted by said Court on January 21, 1971. A petition for rehearing filed pursuant to said Order was denied by order of that Court dated March 8, 1971, and this petition for certiorari was filed within ninety (90) days of that date. Jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

Questions Presented

Whether the broad administrative powers granted to the trustee by the trust instruments at issue precluded the value of the charitable remainder of the trusts from being "presently ascertainable" at decedent's death and therefore not entitled to estate tax deduction as charitable bequests.

Statutes and Regulations Involved

The provisions of Section 2055(a) of the Internal Revenue Code of 1954[2] and Section 20. 2055(a) and (b) of the Regulations thereunder are set forth in Appendix D (36a).

---

2. References to the "Code" shall mean the Internal Revenue Code of 1954 (26 U.S.C. 1964 ed.).

Statement of the Case

Since the detailed relevant facts appear in both the opinions of the Tax Court and United States Court of Appeals for the Third Circuit (appended hereto) and are not in dispute, only a brief summary of the facts will be made here.

In 1960 Lillie MacMunn Stewart created an inter vivos trust, naming a bank, now the Manufacturers Hanover Trust Company, as sole trustee. For the purposes of these proceedings, the provisions of the two trust instruments were identical, providing for the payment of trust income to Mrs. Stewart for life, then to two successive life beneficiaries. Upon the death of the last surviving life tenant, the trust property was to be distributed to named charities, all of which meet the requirements of Section 2055(a)(2) of the Internal Revenue Code of 1954. The trust agreements provided in their relevant provisions as follows:[3]

> "4. The trustee shall have the following powers, authority and discretion, which it may exercise in its sole and absolute discretion whenever and as often as it may deem advisable without application to or approval by any court, namely:
>
> To retain any property herwith or hereafter placed in trust and to receive, invest and retain stocks (whether common or preferred), bonds, securities, undivided interest in any real and personal property, shares or interests in investment companies or invest-

3. For trust instruments in full, see R2, pages 9 through 30.

ment trusts, any Common Trust Fund maintained by the corporate trustee and any property, real or personal, foreign or domestic, whether or not wasting assets, without any duty to diversify and without any restriction placed upon fiduciaries by any present or future applicable law, rule of court or court decision, and from time to time to hold property uninvested without liability for interest or loss of income . . . .

To apportion to principal or to income or in part to both, any rents, dividends, interest or other income accrued or declared, but unpaid, in respect of any property at the time of the receipt of such property by the trustee, any dividend of whatever kind or nature, any property received upon any exchange, reorganization, recapitalization, consolidation, merger or dissolution, any rents, royalty or payment received in respect of any so-called 'wasting asset' or so-called 'unproductive property' or any other receipt whatsoever, to determine whether or not to amortize in whole or in part, the premium at which any property may be received or held or any depreciation on or any expense in connection with any property, real or personal, to discontinue any sinking fund or depreciation as income in whole or in part and to pay from principal or income or in part from both, any deficit from the operation of any improved or unimproved property or any charge against the trust estate, to distribute property determined to be income

and to hold property to any person then or thereafter interested in the trust estate, upon the termination of any trust to pay any accrued rents, dividends, interest or other income to the next estate without apportionment and in connection with the foregoing to follow or depart, in whole or in part, from any rule of law, provided that nothing herein shall authorize an illegal accumulation of income.

In all matters to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care.

* * *

12. This indenture shall be construed, regulated and administered in all respects in accordance with the laws of the State of New York, except as otherwise herein expressly provided."

Mrs. Stewart died in 1964. Because of her retained life income interest, the trust was included in her gross estate under Sec. 2036 of the Code. A charitable remainder was claimed under Sec. 2055 of the Code for the present value of the remainder interest.

The Commissioner contended that the remainder interest was not presently ascertainable because

of the administrative powers of the trustee. The Tax Court, in a decision reviewed by the full Tax Court unanimously, upheld the charitable deduction. The United States Court of Appeals for the Third Circuit, on appeal by the Commissioner, reversed and disallowed the deduction.

1. The Decision Below Determines Erroneously An Important Question of Federal Tax Law Which Should Be Settled By This Court.

A resolution by this Court of a uniform and universal standard under and by which the recognized test of "present ascertainability" can be applied, in a determination of remainder valuation for estate tax purposes, is of the utmost importance in the just administration of the federal tax laws. The obvious effect of the decision in the Court of Appeals below is the threat to the charitable deduction in the case of transfers not subject to the Tax Reform Act of 1969.[4] The possibility of disallowance on the basis of broad administrative powers will be inequitable in the case of settlors who have already established irrevocable

4. Under the Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487, a charitable remainder interest (passing under a will executed after October 9, 1969, from a decedent dying after December 31, 1969) is not deductible unless the trust qualifies as an "annuity trust" (under which the income beneficiary is to receive a stated dollar amount annually) or a "unitrust" (under which the income beneficiary is to receive an annual payment based on a fixed percentage of the net fair market value of the trust assets). See Section 201(d), (e) and (g) of the Tax Reform Act of 1969.

inter vivos trusts incorporating such powers as are present in this case and will certainly deny to the charitable organizations, the protection and nurturing which have so long been a foundation of our tax structure.

This Court, in the case Ithaca Trust Co. v. United States, 279 U.S. 151 (1929), in facing the effect of a trustee's power to directly invade principal for the benefit of the life beneficiary, established the doctrine that the possibility of exercise of a direct power of invasion in favor of an income beneficiary did not preclude the deduction of a charitable remainder for estate tax purposes, where in the words of Mr. Justice Holmes, "There was no uncertainty appreciably greater than the general uncertainty that attends human affairs," (279 U.S. at p. 154). Thusly, this Court early recognized that, by the very nature of human endeavors, certain variables will affect the value of the charitable remainder in these cases.

The Court of Appeals below erroneously concluded that the standard stated in the Ithaca case, supra, was not in fact a standard at all but, merely, a limited test adapted by this Court to the facts of that case. The Court of Appeals adopted the Government's contention that this Court's decisions in the cases, Merchants Bank v. Commissioner, 320 U.S. 256 (1943); Henslee v. Union Planters Bank, 335 U.S. 595 (1949) and Commissioner v. Sternberger's Estate, 348 U.S. 187 (1955), severely limited the standard established by the Ithaca case, supra, and had in fact resulted in guidelines requiring that even the possibility

of evasion not subject to some "ready standard" would be sufficient to disqualify a charitable deduction. Such guidelines cannot be faithfully and universally applied to either the cases this Court has previously considered, involving invasion of the principal upon the direct instructions of the settlor as represented by all of the cases cited above, or upon the question at Bar, which comes to this Court for the first time, where the trustee has no power of direct invasion, possessing only administrative powers, admittedly broad in scope, but designed and intended to permit the trustee to protect, not deplete, the trust corpus.

This follows for three reasons not fully considered by the Court of Appeals below. First, there exists not the possibility but the probability that the value of every income and remainder interest of all trusts will constantly be subject to increase and diminution by reason of the change in market conditions, subjective decision of purchase and sale made by the trustee's world currency condition and the other variables alluded to by Mr. Justice Holmes in the Ithaca case, supra. Certainly, there exists no "ready standard" to measure the effect such variables will have on any remainder interest when viewed from the date of original tax valuation. To admit this premise and require a "ready standard" for deductibility qualification would result, potentially, in no trust's qualifying for a deduction. This, neither Congress nor this Court has ever held to be a valid concept. What Justice Holmes said in the Ithaca case, supra, is quite different, for this Court, there, determined that, while certainly a standard must be

applied to method, means and extent of invasion of the principal, such standard must take into consideration the very nature of human endeavors and the resulting unknown quantity of change to be experienced in their application. In the cases following,[5] this Court has admittedly constricted and severely limited the doctrine of the Ithaca case, supra, giving rise to the confusion that now exists in this area.[6] The wisdom of this limitation has continued to concern the members of this Court as the dissenting opinion of Mr. Justice Frankfurter in the Henslee case, supra, and the dissenting opinions of Mr. Justice Reed and Mr. Justice Douglas in the Sternberger case, supra, reflect.

Secondly, in failing to clearly distinguish the different nature of the direct invasion cases as treated by this Court from the case at Bar and considering them analogous has been fatal to a proper treatment of the issue by the Court of Appeals below. In this difference lies a compelling reason for this Court to consider the issues raised by this case. All of the above-discussed cases decided by this Court dealt with powers of the trustee to divert the corpus of a trust to non-charitable life beneficiaries, specifically expressed in the trust agreement, in terms fixed by the settlor and imposing a duty on the trustee to

5. Merchants Bank v. Commissioner, supra, Henslee v. Union Planters Bank, supra, and Commissioner v. Sternberger's Estate, supra.

6. See footnote 4 for legislative clarification of this issue subsequent to December 31, 1969.

invade the corpus under certain conditions. Therein is an expressed intention of a settlor favoring the well being of the income beneficiary. In the present case, however, the exact opposite exists. The settlor does not direct invasion of the corpus and in this sense demonstrates concern for the retention of maximum value for the charitable remaindermen. The Court of Appeals below erred in considering this a power of indirect invasion.

Historically, our courts have properly held that the dispositive provisions of a trust instrument, inasmuch as they reflect the expressed intention of the settlor, shall prevail. Despite this cornerstone of our jurisprudence and despite the fact that settlors of such trusts may not now be in a position to amend such provisions, the rule of this case, as established by the Court of Appeals below, would disallow the charitable remainder deduction. This would be done on the mere possibility, however remote, that the trustee might in fact exercise the power to the detriment of the charitable remaindermen through utilization of purely administrative powers granted to protect the trust corpus from the vicissitudes of human nature and of our economy as previously referred to and directly contra to the expressed dispositive provisions of the instrument. No decision of this Court supports such a rule.

Thirdly, the Court of Appeals below erred in rejecting, as an appropriate "ready standard," the control and supervision afforded by the laws and decisions of the State of New York to the

administration of trusts in that State. The holding of that Court in this case would seemingly strike a blow at the concept of faith and confidence in the administration of trusts by trustees. For, as the petitioner has consistently argued from the inception of this case, "good faith" and actions in accordance therewith are the very foundation of trusts and trustees as conceived by our law. Omitting for the moment, a detailed discussion of the law of the State of New York and the manner which it here pertains, there is no doubt, and the Government does not argue otherwise, that the courts of New York have always held trustees to the basic standard of exercising good faith in their administration of trusts. (See Part 2 hereof for detailed discussion.) In fact, courts of every jurisdiction in our country have been consistent in requiring this standard of conduct on the actions of all trustees.

The Court of Appeals below did in fact recognize this standard but held it could not apply here because a trustee, acting from the purest of motives and utilizing such powers, could diminish the remainder interest. This is true. However, the salient point overlooked by the Court below is that, in so acting, the trustee is merely reflecting human response to changing circumstances. If the trustees' actions result in diminution of the remainder interest and if the trustee has acted in good faith favoring neither the income beneficiary nor the remainderman, the change in the remainder interest is no more than results from the constant change present in human affairs. Recognizing the one without applying the

other is fatal to a proper determination of the issues in this case. In denying this basic concept of good faith as a standard upon which the "presently ascertainable" test can be measured, the Court of Appeals below has forged a crack in the foundation of the building of high moral and ethical standards which have always been and, hopefully, will continue to be the guidelines of economical endeavor in our country. This guideline has been one our courts have always been willing and competent to effectively measure and adjudicate. Such a standard should not be discarded.

2. The Decision Below Erroneously Determined and Applied the Law of the State of New York As Same Has Been Interpreted by the Courts of that State and the United States District Court for the Southern District of New York.

The effect of the decision of the Court of Appeals below is to decide an important point of New York law having widespread tax implications. With all due deference to that Court, petitioner submits that it did so erroneously.[7] The Tax Court determined that, based on the holdings of the New York courts in a line of cases, including Matter of Talbot, 170 N.Y. Misc. 138, 9 N.Y.S. 2d 806 (Surr. Orange 1939); Matter of Heinrich, 195 Misc. 803, 90 N.Y.S. 2d 875 (Surr. Monroe 1949); Mat-

7. See also "Memorandum of the Corporate Fiduciaries Association of New York City in Support of Appellee's Petition for Rehearing and For Leave to File a brief Amicus Curiae Upon Such Rehearing," filed by Kelley, Drye, Warren, Clark, Carr & Ellis, attorneys, in this case in the Court of Appeals below and set forth in full at R8.

ter of Clark, 275 N.Y. 1 (1937); Matter of Matthews, 255 App. Div. 80, 5 N.Y.S. 2d 707, affirmed, 279 N.Y. 732, 18 N.E. 2d 683 (1958); Matter of Hubbell, 307 N.Y. 246 (1951); Matter of Dickson, 237 N.Y. 2d 572 (Surr. N.Y. 1963); Matter of Muller, 24 N.Y. 2d 336, 300 N.Y.S. 2d 341 (1969), that a trustee must exercise discretion in a prudent and equitable manner, consistent with his duty of equal loyalty to all beneficiaries. Likewise, in Carrier v. Carrier, 226 N.Y. 114, 123 N.E. 135 (1919) where the grantor of the trust retained for his life, the power to direct investments in an absolute and uncontrolled manner, the New York Court of Appeals held that the grantor was in effect the trustee and stated:

> "It is true that the creator of this trust had reserved to himself the broadest rights of management. His discretion was to be 'absolute and uncontrolled.' That does not mean, however, that it might be recklessly or wilfully abused. He had made himself a trustee; and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of trustee. He had power to 'invest' the monies committed to his care. He had no power, under cover of an investment, to loan them to himself, (a point at issue in the case). His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust." 226 N.Y. 114 at 125.

A trustee in New York must at all times act solely for the best interest of all of the beneficiaries of the trust and is permitted to have no reason for acting otherwise. As summarized by the Court of Appeals below, the Surrogate's Court of Orange County, in Matter of Talbot, supra, held that such administrative powers "to determine items of corpus and income was to be exercised in accord with settled principles of allocation, and was meant only to protect the trustee in doubtful situations."

The Court of Appeals below suggests, however, that this policy has been changed by New York Estates, Powers and Trusts Law,[8] although recognizing that this act has no application to the case at Bar. This conclusion is simply erroneous and is graphically rejected by the decision of Judge MacMahon, in the case, Bankers Trust Co. v. United States, 308 F. Supp. 545 (S.D.N.Y.. 1970) where, agreeing fully with the decision of the Tax Court in this case and holding that charitable remainders there qualified for a deduction despite the trustee's power to invest in wasting assets and allocate all cash received to either income or principal, he stated at pages 547 and 548:

> "The trusts here do not, however, grant trustees a power to invade corpus. The trustees can invest in wasting assets and can allocate cash dividends to income, but

8. The EPTL is not applicable to the trusts created by Mrs. Stewart because she died prior to its effective date (see EPTL Para. 1-1.5).

these powers must be read consistently with testator's obvious intention to grant the corpus of the trust to charity. If we were to construe these powers as an unfettered discretion to invade, and even consume, the corpus of the trust, we would be allowing the trustees the power to completely eradicate the remainder interest and therefore alter testator's plan for the distribution of her estate, without there being any direct grant of such broad discretionary power.

The New York law imposes on a trustee the duty to act with fidelity for the benefit of both the income beneficiaries and the remaindermen. If trustees were to use their power to allocate receipts in a manner that would deplete or consume the trust corpus, they would certainly be violating their equitably-imposed fiduciary duty to act in the best interest of the charitable remaindermen and the remaindermen could invoke equity to prevent or void their action or hold them personally liable for the breach of trust.

The trustees' powers, therefore, to invest in wasting assets or to allocate cash receipts to principal or income is not an indirect power of invasion because it is limited by the testator's obvious intention of granting the remainder to charity and by New York law which requires a trustee to act for the benefit of the remaindermen. The charitable remainder is ascertainable and qualifies for a deduction from gross

estate under Paragraph 2055 of the Internal Revenue Code." (Emphasis added.)

The Court of Appeals below erroneously rejected the determination of the United States District Court for the Southern District of New York in this regard.[9]

The State of New York is not within the jurisdiction of the Court of Appeals for the Third Circuit, and the Court of Appeals for the Second Circuit has not to date made a determination on the question here present nor to petitioner's knowledge is such a determination pending.[10] A real question then exists, whether under the rule of Commissioner of Internal Revenue v. Estate of Herman J. Bosch, 387 U.S. 456 (1967), in the absence of a holding of New York's highest state court or the United States Court of Appeals for that jurisdiction, left the Court of Appeals below free to disregard the decision of the United States District Court for the Southern District of New York on the impact of the New York law. We respectfully submit it does not. In that case, this Court held that, where federal estate tax liability turns

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9. The decision of the Court of Appeals below reflects in part, a mistaken view of the facts in that case (15a). The decision indicates that the Court may have been influenced by the fact that the life tenants had died and the charitable remainder already disbursed. This, however, was true of only two of the seven trusts involved therein.

10. Bankers Trust Co. v. United States, supra, is on appeal to the Court of Appeals for the Second Circuit but the Government has not appealed that case on the issues herein pertinent. See also footnote No. 5 (7a).

on character of a property interest held and transferred by decedent under state law, federal authorities are not conclusively bound by determination made of such property interest by a state trial court in proceedings in which the United States is not a party. While the decision in that case does not directly answer our inquiry here, its reasoning leads us easily to the conclusion that the Court of Appeals below should have accepted in this case the determinations of the United States District Court on the very same point in question relative to New York law, absent a determination by the Circuit Court of Appeals for the Second Circuit or the state court. This court reasoned in the Bosch case, supra, that the United States could not be bound on determinations in state courts in which it was not a party. In the Bankers Trust case, supra, the Government was a party, the issue was the same as here presented, many lower state courts had decided similar issues and, absent a higher federal court ruling, the decision of the United States Court for the Southern District of New York clearly defines and establishes New York state law for the purposes of this case. All of the criteria of the Bosch case, supra, have been satisfied and the Court of Appeals below was bound to the determination of the United States District Court in that jurisdiction. To hold otherwise would tend to create uncertainty in all interstate relationships and is not in keeping with the determination of this Court in the Bosch case. This issue, in relation to its applicability to this case, is deserving of review by this Court.

3. The Decision Below is in Conflict With the Decisions and Determinations of the United States Court of Appeals for the First Circuit and other Federal Courts.

In the administrative proceedings before the Internal Revenue Service and as recognized by the Tax Court below, the Government placed heavy reliance in asserting its position on the holding of the United States Court of Appeals for the First Circuit in State Street Trust Co., et al, v. United States, 263 F.2d 634 (C.A. 1, 1959). That Court, in considering the effect of much broader administrative powers granted to the trustee, including exculpatory provisions releasing the trustee from liability, held that the trustees were not limited by any ascertainable standard and that, therefore, the remainder interest failed the test of "present ascertainability." This petitioner has consistently argued and the Tax Court below correctly determined the basic weakness of the State Street case, supra, as expressed by Chief Judge Magruder (C.A.-1) in his dissenting opinion in that case, where he said, with obvious persuasiveness, that the majority opinion stretched the statutory language too far, when it held that a Massachusetts court could not effectively control the exercise of the granted powers and thereby created an interpretation that, when such powers were granted, they were, in reality, "rights." Judge Magruder was of the firm opinion that adequate safeguards and standards were created and maintained by the jurisdictional law of Massachusetts.

More importantly, however, petitioner submits that the Court of Appeals for the First Circuit itself specifically overruled the State Street case, supra, in Old Colony Trust Company, et al, v. United States, 423 F.2d 601 (C.A. 1, 1970).[11] In that case involving the same basic, broad administrative powers and questions as are at issue here and as were presented in the State Street case, supra, Chief Judge Aldrich said at page 602:

> ". . .If State Street Trust Co. v. United States, 1 Cir., 1959, 623 F.2d 635, was correctly decided in this aspect, the government must prevail because of the Article 7 powers . . . .
>
> . . .Trustee powers given for the administration or management of the trust must be equitably exercised, however, for the benefit of the trust as a whole. . . . The Court in State Street conceded that the powers at issue were all such powers, but reached the conclusion that, cumulatively, they gave the settlor dominion sufficiently unfettered to be in the nature of ownership. With all respect to the majority of the then court, we find it difficult to see how a power can be subject to control by the probate court, and exercisable only in what the trustee fairly

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11. The facts of the Old Colony Trust Company case, infra, do not involve charitable remainders but the issue relates directly to the effect of broad administrative powers on estate tax liability and for this purpose are directly in point.

concludes is in the interests of the trust and its beneficiaries as a whole, and at the same time be an ownership power.

The Government's position, to be sound, must be that the trustee's powers are beyond the court's control. Under Massachusetts law, however, no amount of administrative discretion prevents judicial supervision of the trustee."

The Court of Appeals below, in its decision in this case, considered only that the United States Court of Appeals for the First Circuit had qualified the State Street Trust case's decision and had done so only because of the Massachusetts' law. Petitioner respectfully submits that the true effect of the Old Colony Trust Co. case, supra, was to overrule the very facet of that case which the Court of Appeals below used in support of its reasoning and determination in this case. Petitioner's view as to the overruling of the State Street Trust case, supra, is supported by other authorities in this field.[12] There is, in fact, no difference between the laws of Massachusetts and New York as they pertain to the control and supervision of trustees in their exercise of administrative powers and the Court of Appeals below does not, in reality, or otherwise, indicate such differences.

The Court of Appeals for the First Circuit

12. See 70-1, U.S.T.C., 12,667 notations at page 83,759, and Tax Management Memorandum TMM 70-06, March 22, 1971.

has held that Massachusetts courts, because they require the trustees to act fairly and justly to all beneficiaries, have established a sufficient standard to permit satisfaction of the test of "present ascertainability" for estate tax purposes. The United States Court of Appeals for the Third Circuit, in this case, has determined in effect that in New York, whose state courts hold to the same doctrine as the Massachusetts courts, a taxpayer will be denied a deduction. These decisions constitute a basic conflict which should be resolved by this Court.

The United States Court of Appeals for the Fifth Circuit has recently decided the case, First National Bank in Palm Beach and Phillip P. O'Connell, Co-Trustees, v. United States, F.2d , 71-1 U.S.T.C. 12, 777, case No. 29453, decided May 7, 1971, and companion cases,[13] in which the same basic issue has been involved. That court has followed the erroneous reasoning of the Court of Appeals below and concluded that such administrative powers granted trustees the right and power of indirect invasion. That court relied upon the rule stated by Scott,[14] that a trustee's determination in allocating to trust receipt principal or interest is conclusive unless he has abused the discretion granted to him. Both the Courts of Appeal for Third Circuit and Fifth Circuit have, unlike

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13. See Miami Beach First National Bank v. United States, ____ F.2d ____ (C.A. 5, 1971) decided April 30, 1971, 71-1, U.S.T.C., 12,776.

14. Scott, Trusts, 3rd ed., Sec. 233.5.

the Court of Appeals for the First Circuit, overlooked what the petitioner submits to be a proper understanding and interpretation of such a rule. For it is not with such a rule that petitioner argues. The important concept to be applied is that the respective state courts will afford control and will prevent a trustee from favoring one beneficiary against the interests of the other. For a trustee to do so would be to abuse his discretion and this, the state courts will not permit. In this control and supervision lies the essential element creating and preserving the "ready standard" upon which the test of "present ascertainability" can be satisfied.

Demonstrating the confusion that has resulted from the decision of this case by the Court of Appeals below and which it is submitted will continue to manifest is the recent decision by the United States District Court, Southern District of Ohio, Western Division, in the case Estate of Harry A. Toulmin, Jr., Virginia Bernthal Toulmin, Executrix, v. United States, Fed. Supp. Case No. 3710, decided March 19, 1971, 71-1 U.S.T.C. 12,775, where that court discusses, at length, the holding of the Court of Appeals in this case and the decision of the Court of Appeals for the First Circuit in the Old Colony Trust Company case, supra. The United States District Court, in that case, was persuaded by the reasoning of the Court of Appeals for the First Circuit and recognized the conflict with the decision in this case, resolving the question between the two different decisions on a factual basis, when in fact a detail review of these cases will not indicate any ma-

terial factual difference as they pertain to the issues presented herein.

4. Public Policy Considerations Support Reversal of the Decision of the Court of Appeals Below.

The protection and nurturing of charitable organizations are a recognized facet of our entire tax structure. The charitable deduction granted in Section 2055 of the Code expresses long-established public policy and the Commissioner of Internal Revenue should not be allowed to prevent a magnanimous donor from obtaining a charitable deduction for a charitable remainder by an extended and unsupported interpretation of federal legislation on the subject.

As previously pointed out (see footnote 4), Congress, after extensive consideration in this area, revealed that the change made by the Tax Reform Act of 1969, P.L. 91-172 (83) stat. 487, had not clearly prevailed before. Thus, the provisions of the New Act have changed the law in this regard in a proper legislative manner. Congress has seen fit to draw a more stringent standard. The Government is not, however, entitled to its provisions in application to this case. A careful analysis reflects that the share a charity will actually receive in such cases is always contingent on events far more speculative than the Government fears exists in this case. For example, the trustee's selection of investments, although legal, may prove to be unwise. Recent market fluctuations have decreased the value of the corpus. Likewise, such investments may

produce high income but fail to provide an increase of capital or even provide a diminution of corpus. Viewed in this perspective, the possible reduction in the value of corpus, resulting from a trustee's impartial and lawful exercise of powers granted to him to make principal-income allocation, is not very significant.

The trustee must possess discretion to operate effectively and must exercise it properly; and if it does, and the law and equity will insure that it does, the principal is rendered ascertainable. Reference to the actual handling of the trust assets vividly demonstrates that this discretion has not been violated (32a). Truly, as in this case, the best security for a charitable remainderman lies in giving the trustee proper administrative provisions as guidelines for ensuring its discretionary authority.

Petitioner respectfully submits it is apparent from the foregoing discussion that the decision of the Court of Appeals in this case was not founded correctly on either the guidelines established by this Court or the proper determination and application of the laws of the State of New York. The decision is in conflict on the main issue with that of another United States Court of Appeals and has resulted in confusion in the lower courts and among members of the Bar active in this field. The resolution of these issues by this Court is imperative for the proper disposition of this case and for the future guidelines of our courts and Bar in their interpretation of the effect and meaning of such provisions.

Conclusion

For the foregoing reasons, a Writ of Certiorari should issue to review the judgment and opinion of the Third Circuit.

Respectfully submitted,

s/ Edwin M. Dotten, Jr.
57 Union Place
Summit, New Jersey 07901
Counsel for Petitioner

Of Counsel

Lemuel Skidmore
Hartlaub, Braun, Thorn, Dotten & Skidmore
57 Union Place
Summit, New Jersey 07901

APPENDIX A

Sur Petition for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 18,947

ESTATE OF LILLIE MacMUNN STEWART

v.

COMMISSIONER OF INTERNAL REVENUE

Present: Judges Hastie, McLaughlin, Freedman, Seitz, Van Dusen, Aldisert, Adams, Gibbons, Rosenn

The petition for rehearing filed by

ESTATE OF LILLIE MacMUNN STEWART

in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court en banc,

Sur Petition for Rehearing

the petition for rehearing is denied.

By the Court,

s/ Alan M. Adams
Judge

Dated: 3/8/71

APPENDIX B

Opinion of the Court

(Filed 1/5/71)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 18,947

ESTATE OF LILLIE MacMUNN STEWART,
Deceased, W. ALAN HENDERSON,
Executor

v.

COMMISSIONER OF INTERNAL REVENUE,
Appellant

On Appeal From the United States Tax Court

Argued November 20, 1970

Before Hastie, Chief Judge, McLaughlin
and Adams, Circuit Judges

Adams, Circuit Judge.

Because private philanthropy is so deeply rooted in our society, Congress has been persistently confronted with the problem of resolving what types of incentives are appropriate in the Federal tax system for charitable contributions. A traditional incentive has been the allowance of a deduction in the computation of income estate, and gift taxes for amounts given to charities.[1]

1. See §§170, 2055, 2522 of the Internal Revenue Code of 1954, 26 U.S.C.A. §§170, 2055, 2522 ("the Code").

The form in which gifts may be made so as to qualify under the estate tax deduction provision is quite broad.[2] Often such bequests are made in the form of charitable remainder trusts, allowing the decedent to provide for non-charitable beneficiaries, perhaps for their lives, before the charitable remainderman receives anything. To determine the proper deduction in such cases, the Estate Tax Regulations ("the Regulations") provide for a deduction if (1) the charitable interest is "presently ascertainable, and hence severable from the non-charitable interest," and (2) viewing the circumstances as of the date of decedent's death, "the possibility that the charitable transfer will not become effective is so remote as to be negligible."[3]

The question presented on this appeal is whether the broad administrative powers here granted to the trustee by the trust instruments precluded the value of the charitable remainders of the trusts from being "presently ascertainable" at the decedent's death. Only if it is decided that the value was presently ascertainable need the further question regarding the likelihood of ex-

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2. §2055(a) "Transfers for public, charitable, and religious uses. For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers . . . (2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes. . . ."

3. See Estate Tax Regulations §20.2055-2(a) and (b) (Treasury Regulations 26 C.F.R. §20.2055-2(a), (b)).

ercise of the power be considered.[4]

The relevant facts in this case are not in dispute. On May 24, 1960, Lillie MacMunn Stewart created two trusts, naming what is now the Manufacturers Hanover Trust Company as sole trustee. For purposes here pertinent, the two trust instruments were identical providing that the income of the trusts be paid to decedent for life, then to her sister for life, and then to her brother-in-law for life. Upon the death of the last surviving life tenant, the corpus was to be distributed to named charities which meet the requirements of §2055(a)(2) of the Code (see footnote 2). The trust agreements provided in part as follows:

> "4. The trustee shall have the following powers, authority, and discretion, which it may exercise in its sole and absolute discretion whenever and as often as it may deem advisable without application to or approval by any Court, namely:
>
> To retain any property herewith or hereafter placed in trust, and to receive, invest in and retain stocks (whether common or preferred), bonds, securities, undivided interests in any real and personal property, shares or interests in investment companies or investment trusts, any Common Trust

4. See generally, 4 Mertens, Law of Federal Gift and Estate Taxation, §28.37 at pp. 397-398 (Moskowitz Ed. 1959). Taggart Charitable Deductions for Transfers of Remainder Interests Subject to Invasion, 21 Tax L. Rev. 535, 562-3 (1966).

Fund maintained by the corporate trustee, and any property, real or personal, foreign or domestic, whether or not wasting assets, without any duty to diversify and without any restriction placed upon fiduciaries by any present or future applicable law, rule of court or court decision, and from time to time to hold property uninvested without liability for interest or loss of income....

To apportion to principal or to income or in part to both any rents, dividends, interest or other income accrued or declared, but unpaid, in respect of any property at the time of the receipt of such property by the trustee, any dividend of whatever kind or nature, any property received upon any exchange, reorganization, recapitalization, consolidation, merger or dissolution, any rents, royalty or payment received in respect of any so-called 'Wasting asset' or so-called 'unproductive property' or any other receipt receipt whatsoever, to determine whether or not to amortize in whole or in part the premium at which any property may be received or held or any depreciation on or any expense in connection with any property, real or personal, to discontinue any sinking fund or depreciation or depletion reserve and to treat the same as income in whole or in part and to pay from principal or income or in part from both any deficit from the operation of any improved or unimproved property or any charge against the trust estate, to distribute property determined to be income and to hold property

determined to be principal without liability to any person then or thereafter interested in the trust estate, upon the termination of any trust to pay any accrued rents, dividends, interest or other income, to the next estate without apportionment and in connection with the foregoing to follow or depart, in whole or in part, from any rule of law; provided that nothing herein shall authorize an illegal accumulation of income.

In all matters to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care.

12. This indenture shall be construed, regulated, and administered in all respects in accordance with the laws of the State of New York, except as otherwise herein expressly provided."

Because the decedent retained a life estate in the two inter vivos trusts, the trusts were included in her gross estate under §2036 of the Code when she died on May 6, 1964. The estate claimed a charitable deduction for the present value of the trust remainders under §2055 of the Code. The Commissioner, however, asserted that the broad administrative powers quoted above rendered the deduction unavailable because the charitable interests were not "presently ascertainable" and there was no assurance that the charities would receive the bequest. The Tax

Court upheld the charitable deduction in an opinion reported at 52 T.C. 830 (1969), and the Government has appealed.

This case presents the first instance in which a Court of Appeals has decided whether broad administrative powers in a charitable remainder trust may allow a trustee such power to deplete corpus in favor of non-charitable life beneficiaries so as to make the value of the gift not "presently ascertainable."[5] Such problem will not arise for estates subject to the Tax Reform Act of 1969 because §§201(d), (e) and (g) of that Act require that a trust pay either a fixed dollar amount or a fixed percentage of net fair market value of the trust assets to the life beneficiaries before the charitable remainder is eligible for the deduction.[6]

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5. At least four similar cases are presently pending before the Courts of Appeals: Gardiner v. United States, F. Supp. (D. Ariz. 1969); First National Bank in Palm Beach v. United States, F. Supp. (S.D. Fla. 1969); Miami Beach First National Bank v. United States, F. Supp. (S.D. Fla. 1969); Peoples Trust Co. of Bergen County v. United States, 311 F. Supp. 1197 (D.N.J. 1970). The same question was considered in Bankers Trust Co. v. United States, 308 F. Supp. 545 (S.D.N.Y. 1970), but the Government has appealed only on other issues. See also Florida National Bank at Lakeland, F. Supp. (M.D. Fla. 1970).

6. See Pub. L. 91-172, 83 Stat. 487, 560-565 (codified in §§642(c)(5), 664, 2055(c) of the Internal Revenue Code of 1954). See also H.R. Rep. No. 91-413, 91st Cong. 1st Sess. 58-60 (1969); S. Rep. No. 91-552, 91st Cong. 1st Sess. 86-91 (1969). See also §§201(f)(4)(B), (C) of the Tax Reform Act of 1969 for the detailed exceptions to application of the Act to decedents dying after 1969.

The Supreme Court has repeatedly scrutinized powers to invade corpus, holding that the possibility of invasion, not subject to some "ready standard," is sufficient to disqualify a charitable deduction. Indeed, in Henslee v. Union Planters Bank, 335 U.S. 595 (1949), the Court found the chance of invasion, on behalf of an 85 year old widow with independent income and no dependents to be "remote," but held that a power to invade corpus for the woman's "pleasure, comfort and welfare" was not subject to a standard sufficiently definite to make the amount of the charitable remainders a presently ascertainable sum.[7] This decision was based on an earlier case which similarly had held that a power to invade "for the comfort, support, maintenance and/or happiness of my ... wife," the trustee to exercise his discretion "with liberality," was too broad to constitute an "ascertainable standard" which was "fixed and capable of being stated in definite terms of money." Consequently, the Court held that the present value of the charitable remainder was not ascertainable. Merchants National Bank v. Commissioner, 320 U.S. 256, 257-258, 263 (1943).

In contrast to the foregoing cases the Supreme Court upheld a charitable deduction where the power to invade extended to amounts "that may be

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7. For an example of disallowance of the deduction because of requirement that as of the date of death, "the possibility that the charitable transfer will not become effective is so remote as to be negligible." See Commissioner v. Sternberger's Estate, 348 U.S. 187 (1955).

necessary to suitably maintain [my wife] in as much comfort as she now enjoys." Ithaca Trust Co. v. United States, 279 U.S. 151, 154 (1929). Both the taxpayer and the Tax Court place great emphasis on the language of Mr. Justice Holmes in Ithaca Trust, supra, at 154, where he stated that the above power would not preclude a charitable deduction since the uncertainty of the amount of the gift to the charity was not "appreciably greater than the general uncertainty that attends human affairs." That statement, however, was made in the context of a finding by the Court that the above standard "was fixed in fact and capable of being stated in definite terms of money," and that the income of the trust was "more than sufficient to maintain the widow as required" by the stated standard. Mr. Justice Holmes' statement, therefore, actually amounted to determining it was very unlikely, in view of the amount of the income generated by the corpus, that principal itself would have to be invaded. As the Tax Court aptly stated below, "[a]ll trusts are subject to the vicissitudes of the economy as well as depletion through unwise, if not imprudent or unreasonable decisions on the part of the trustees." 52 T.C. at 836. If, however, invasion were to become necessary, the amounts would be subject to a readily ascertainable standard. This narrow holding has since been strictly applied by the Supreme Court in Merchants Bank, supra; Union Planters Bank, supra; and Sternberger's Estate, supra.

Taxpayer argues that none of the above cases is controlling here because they each involved

direct, dispositional powers to invade corpus, whereas Mrs. Stewart's trust agreement allows only indirect, administrative invasions of corpus. The taxpayer contends that such powers are only incidental and intended to allow the trustee to resolve doubtful cases without resorting to a court ruling or risking a surcharge. Indeed, despite the extremely broad language of the powers conferred here, taxpayer argues that New York courts would hold the trustee to a measurable and ascertainable standard.

The government contends that the possible effects of the indirect powers of invasion granted in the Stewart trusts are analogous to what the Supreme Court has condemned in the cases cited above, and that the Tax Court and the taxpayer have misconstrued the law of New York.

As this Court stated in Zentmayer's Estate v. Commissioner, 336 F.2d 488, 490 (3rd Cir. 1964), the central issue with respect to powers of invasion is "not what the trustees [are] likely to do, but what they [have] the power to do," and whether that power is limited by an ascertainable standard. In addition, the wording of the trust instrument, rather than extrinsic circumstances, must "furnish the basis for an objective standard" of ascertainability. Seubert v. Shaughnessy, 233 F.2d 134, 137 (2d Cir. 1956). Among the powers granted to the trustee in the Stewart trusts are (1) the power to invest in and to hold any type of property, including shares of investment companies and wasting assets, without the duty to diversify investments, and without regard to restrictions placed

upon fiduciaries by any rule of law; (2) the power to apportion between principal and income any accrued but unpaid income on property acquired by the trust, any dividend of whatever kind, any property received upon a corporate reorganization, consolidation, merger, or dissolution, any payment in respect of a wasting asset and "any other receipt whatsoever"; (3) the power to determine whether or not to amortize the premium at which any property may be received to depreciate any expense in connection with any property; (4) the power to discontinue any sinking fund or depreciation account and to treat the same as income; and (5) the power to pay from either principal or income any deficit from the operation of property or any charge against the trust estate. A most important item in this list is the very broad power to apportion receipts between principal and income. If the powers set forth in the trusts are literally and fully exercised, the charities might receive nothing, or an amount substantially less than that computed actuarilly.[8] For example, the trust corpus could be wholly depleted by investing in a leasehold or mineral interest, and allocating all receipts to the income account. Such result is similar to the possibilities in direct invasion cases.

The crucial question in this case thus becomes whether the ficuciary duties imposed by state law

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8. Because the estate tax must be computed at the time of death, the Regulations provide actuarial tables for computing the present value of remainder interests. See §20.2031-7 of the Regulations.

operate to restrict the trustee's exercise of the above powers in such a manner so as to insure that the amount of the charitable interest is "presently ascertainable." Cf. Peoples Trust Co. of Bergen County v. United States, 412 F.2d 1156 (3rd Cir. 1969). A fundamental concern is whether the charity might not receive benefits commensurate with the amount of the tax deduction allowed because of the terms of the trustee's powers. In this regard we must bear in mind that "the taxpayer has the burden of establishing that the amounts which will either be spent by the private beneficiary or reach the charity are thus accurately calculable." Merchants Bank, supra at 261.

In accordance with the decedent's intent specifically expressed in the trust instrument and the situs of the trusts, the parties have agreed that the laws of New York govern the administration of this trust. An early federal district court decision in New York, Colt v. Duggan, 25 F. Supp. 268 (S.D.N.Y. 1938), considered the effect of a power to allocate items between income and principal for purposes of the income tax deduction allowed for amounts paid or permanently set aside for a charitable purpose under the predecessor of §642(c) of the Code. Because of the other possibilities of invasion in the will, and later developments in New York law, the Colt case offers little guidance now.

The latest federal case construing New York law on this subject is Bankers Trust Co. v. United States, 308 F. Supp. 545 (S.D.N.Y. 1970). The power complained of there was contained in Article

Seventeenth of the will:

> "All stock dividends, to the extent permitted by law, shall be treated as principal and all cash dividends, including extraordinary cash dividends, and dividends on mining stocks and other wasting investments but excluding liquidating dividends, shall be treated as income...."

Judge Lloyd F. MacMahon found that under New York law, this power would not allow the corpus to be depleted to the detriment of the charitable remaindermen without a violation of the trustees' fiduciary duties. We were informed at the oral argument in the present case that the Government has not appealed Bankers Trust on this point. Among the cases relied on by Judge MacMahon is In re Estate of Dickson, 237 N.Y.S. 2d 572, 576 (1963), where the Surrogate's Court for New York County held that an executor must act "for the best interests of all persons interested in the estate." Judge MacMahon pointed out that despite trust provisions granting the trustees investment discretion much broader than that otherwise allowed under what is now the New York Estates. Powers and Trusts Law ("EPTL" McKinney 1967), trustees are not freed from the standards of good judgment and prudence with which all trustees must act. Stated differently, "[t]he yardstick for determining the duties of a trustee is governed by the rule of the 'prudent man.'" In re Gould's Will, 234 N.Y.S.2d 825, 828 (3d Dept. 1962). See also In re Hubbell's Will, 302 N.Y. 246 (1951). Judge MacMahon's

decision may also have been influenced by the fact that the life tenants had died and the charitable remaindermen had in fact received the bequests at the time the question of the charitable deduction was litigated in the district court.

The Court in Bankers Trust could have framed its decision more narrowly, based on a precise reading of the instrument. That is, the term "dividends" used in Article Seventeenth has a specified legal meaning—generally a distribution of the earnings or profits of a corporation to its shareholders. See, for example, the highly articulated rules of EPTL §11-2(e). A distribution by a company owning wasting assets, such as a mining company, must be apportioned between income beneficiaries and remaindermen (at least in the absence of a specific grant of discretion as made in the Stewart trusts) because the income beneficiary is ordinarily entitled only to the income portion of the distribution. Matter of Hopkin's Estate, 14 N.Y.S. 2d 71 (Surr. New York 1939); In re Haldeman's Estate, 143 N.Y.S.2d 396 (Surr. New York 1955); In re McDonnell's Will, 222 N.Y.S. 2d 454 (Surr. Nassau 1961). In addition, Article Seventeenth in Bankers Trust specifically excludes "liquidating dividends" from being treated as income. This provision would appear to offer additional protection to the remainderman with respect to payouts from wasting assets. By contrast to the specific directions of allocation given in Bankers Trust, the trustee of the Stewart trusts has been given plenary power over all receipts. The grant of discretion in the Stewart trusts, therefore, is considerably broader than in Bankers Trust.

Taxpayer relies heavily on In re Talbot's Will, 9 N.Y.S. 2d 806 (1939), which the Surrogate's Court of Orange County did not permit the trustee to allocate an item to corpus rather than to income, even though a clause in the will granted the trustees broad powers "to determine" whether "any moneys, stock or securities received by them are to be considered as capital or income." The court there reasoned that where a will is the work of a competent draftsman, its provisions are to be given their strict legal connotation. Therefore, the above power granted to the trustees must be read in conjunction with the dispositive intent of the decedent in order to ascertain the dimensions of the power. Because of New York's then public policy against accumulating trust income, and because the decedent expressed no intent to overcome this policy, the court held that the power "to determine" items of corpus and income was to be exercised in accord with settled principles of allocation, and was meant only to protect the trustee in doubtful situations.

New York's present public policy on this subject is declared in its Estates, Powers and Trusts Law.[9] Section 11-2.1(a) of that law provides in part:

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9. Although the EPTL is not literally applicable to the trusts created by Mrs. Stewart because she died prior to its effective date (see EPTL §1-1.5), the provisions of §11-2.1 are essentially reenactments of New York Personal Property Law §§27-a-g (enacted April 22, 1964, effective June 1, 1965), which itself was applicable "to any receipt or expense received or incurred after [its] effective date. . . ." (Personal Property Law, §27-m). See also In re Estate of Lecompte, 276 N.Y.S. 2d 208 (Surr. Ct. N.Y. County 1966).

"(1) A trust shall be administered with due regard to the respective interests of income beneficiaries and remaindermen. A trust is so administered with respect to the allocation of receipts and expenditures if a receipt is credited or an expense is charged to income or to principal or partly to each ...(C)... in accordance with what is reasonable and equitable in view of the interests of those entitled to income as well as those entitled to principal and in view of the manner in which men of ordinary prudence, discretion, and judgment would act in the management of their own affairs.

(2) If the trust instrument gives the trustee discretion in crediting a receipt or charging an expenditure to income or principal or partly to each, no inference that the trustee has or has not improperly exercised such discretion arises from the fact that the trustee has made an allocation contrary to the provisions of this section."

The powers of a trustee under §11-2.1(a) are so broad that a substantial question was raised in New York whether a trustee could, in effect, deprive a surviving spouse of substantially all of the income of a trust for her benefit, by the manner in which he allocated receipts and expenses.[10] This problem was solved by specific

10. See Conway, Surviving Spouse's Right of Election in New York Where Trust Income May be Divested, 34 Ford. L. Rev. 593 (1966); see also Surrogate's Association Note appended to EPTL §5-1.1 as amended in 1969.

amendment to EPTL §5-1.1—governing the rights of surviving spouses—which confers jurisdiction on the Surrogate's Court to supervise the fiduciary so as to prevent interference with the spouse's income. Otherwise, the provisions of §11-2.1(a) remain in full effect.

Thus the Government argues that the trustee for the Stewart trusts may well act with the purest motives and always in good faith, but state law will not provide any fixed and ascertainable standard of investment and management conduct for the trustee. Here the decedent's dispositive intent does not reveal any desire to favor the life tenants over the remaindermen, but decedent's administrative intent was to rely solely upon the trustee's judgment and discretion rather than upon the normal rules of state law governing the administration of trusts. Such broad powers have been previously recognized as enabling a trustee, acting safely within his prerogatives, to shift "very substantially ... the economic benefits of the trusts between the life tenants and the remaindermen," State Street Trust Co. v. United States, 263 F.2d 635, 639 (1st Cir. 1959).[11] Al-

11. We note, and fully concur with the limiting concepts expressed by Learned Hand in Stix v. Commissioner, 152 F.2d 562, 563 (2d Cir. 1945): "Nevertheless, we agree that no language, however strong, will entirely remove any power held in trust from the reach of a court of equity. After allowance has been made for every possible factor which could rationally enter into the trustee's decision, if it appears that he has utterly disregarded the interests of the beneficiary, the court will intervene. Indeed, were that not true, the power would not be held in trust at all; the language would be no more than a precatory admonition."

though the First Circuit in Old Colony Trust Co. v. United States, 423 F.2d 601 (1970) has recently qualified the State Street Trust decision as it applies to Massachusetts law, the statement quoted nonetheless remains correct with respect to New York law. The doctrine of In re Talbot's Will, supra, and In re Estate of Lecompte, supra (a trustee must always satisfy the court that the allocation was in fact prudent, if "it [is] challenged")[12] does not provide the requisite ascertainable standard for amounts left to charity where the powers are so broad as here.

Finally, taxpayer argues that the broad language employed in the trust instruments should not be literally construed because it is "mere boiler plate." However, characterizing this critical language does not help us resolve matters of taxability. The issue still persists whether the power of the trustee is limited in a measurable manner. The answer to this question for federal tax purposes cannot be determined by an inquiry into the care or carelessness of the drafter. Estate tax questions regarding powers must be answered by reference to possibilities, even though the powers granted may never be exercised.[13] Under the inquiry regarding possibilities, the amount to be received by the charities here is not "presently ascertainable."

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12. 376 N.Y.S. 2d at 210.

13. Judge Freedman aptly stated these principles in Strite v. McGinnes, 215 F.Supp. 513, 515-516 (E.D. Pa. 1963): "Boiler plate it may be, in the sense that the words may have been

(Cont'd)

Accordingly, the judgment of the Tax Court will be reversed.

A True Copy:

Test:

Clerk of the United States Court of Appeals
for the Third Circuit.

(Cont'd)

chosen indiscriminately by the scrivener without that imaginative understanding which is the hallmark of the skillful draftsman. Executors confronted with substantial tax liability because of the carefree use of words in a will, especially words which never were put to use, must view a scrutiny of their meaning as an academic intrusion into the world of reality. But we deal here with the power to consume property, regardless whether the power was exercised or lay dormant. The grant of power in the will is the test of taxability, and the reality which governs is the language of the grant rather than the extent of its exercise.

APPENDIX C

(Filed 8/14/69)

52 T. C. No. 86

TAX COURT OF THE UNITED STATES

(Same Title)

Docket No. 689-68. Filed August 14, 1969

Decedent established two inter vivos trusts with a reserved life estate, two secondary life estates, and ultimate remainders to named charities. The sole corporate trustee was given discretionary power to allocate receipts and expenditures between principal and income and to invest in wasting assets without provision for a reserve or sinking fund. Held, the discretionary powers did not constitute a power of indirect invasion in favor of the secondary life beneficiaries and the charitable remainders are deductible under sec. 2055, I.R.C. 1954.

Edwin M. Dotten, Jr., for the petitioner.

Owen A. Knopping, for the respondent.

Opinion

TANNENWALD, Judge: Respondent determined a deficiency in petitioner's estate tax in the amount of $56,308.82. The sole issue for our determination is whether the remainder interests in two trusts established by the decedent qualify for a charitable deduction pursuant to section 2055[14] because of the investment and management discretion vested in the trustee.

All of the facts are stipulated and are found accordingly.

Petitioner is the executor of the Estate of Lillie MacMunn Stewart, deceased, who died on May 6, 1964. His legal residence at the time of filing the petition herein was Madison, New Jersey. The estate tax return was filed with the District Director of Internal Revenue, Newark, New Jersey.

On May 24, 1960, the decedent created two trusts by means of separate agreements which named the Hanover Bank, a trust company and bank organized under the laws of New York, now known as the Manufacturers Hanover Trust Co., as sole trustee.

The trusts provided that the income be paid to the decedent for life, then to her sister, Ethel

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14. All references, unless otherwise specified, are to the Internal Revenue Code of 1954, as amended.

MacMunn Henderson, for life, and then to her sister's husband, W. Alan Henderson, for life. Upon the death of all the life tenants, the corpus was to be distributed to named charities, which respondent concedes meet the requirements of charitable organizations specified in Section 2055 (a)(2).

Both trust agreements are identical, except that paragraph three below appears only in the provisions governing trust A, and provide in pertinent part:

> 3. The trustee may pay or apply to or for the use of the grantor so much of the principal, even to the extent of the whole thereof, that it may in its sole discretion deem to be necessary or desirable for her support, care, comfort, and well-being.
>
> 4. The trustee shall have the following powers, authority, and discretion, which it may exercise in its sole and absolute discretion whenever and as often as it may deem advisable without application to or approval by any Court, namely:
>
> To retain any property herewith or hereafter placed in trust, and to receive, invest in and retain stocks (whether common or preferred), bonds, securities, undivided interests in any real and personal property, shares or interests in investment companies or investment trusts, any Common Trust Fund maintained by the corporate trustee, and any property, real or personal, foreign

or domestic, whether or not wasting assets, without any duty to diversify and without any restriction placed upon fiduciaries by any present or future applicable law, rule of court or court decision, and from time to time to hold property uninvested without liability for interest or loss of income.

* * * *

To apportion to principal or to income or in part to both any rents, dividends, interest or other income accrued or declared, but unpaid, in respect of any property at the time of the receipt of such property by the trustee, any dividend of whatever kind or nature, any property received upon any exchange, reorganization, recapitalization, consolidation, merger or dissolution, any rents, royalty or payment received in respect of any so-called "Wasting asset" or so-called "unproductive property" or any other receipt whatsoever, to determine whether or not to amortize in whole or in part the premium at which any property may be received or held or any depreciation on or any expense in connection with any property, real or personal, to discontinue any sinking fund or depreciation or depletion reserve and to treat the same as income in whole or in part and to pay from principal or income or in part from both any deficit from the operation of any improved or unimproved property or any charge against the trust estate, to distribute prop-

erty determined to be income and to hold property determined to be principal without liability to any person then or thereafter interested in the trust estate, upon the termination of any trust to pay any accrued rents, dividends, interest or other income, to the next estate without apportionment and in connection with the foregoing to follow or depart, in whole or in part, from any rule of law; provided that nothing herein shall authorize an illegal accumulation of income;

In all matters to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care.

* * * *

12. This indenture shall be construed, regulated, and administered in all respects in accordance with the laws of the State of New York, except as otherwise herein expressly provided.

At all times between the date the trusts were established and the date of death, the assets of both trusts consisted entirely of small amounts of cash and publicly traded stocks and debt obligations of well-known business corporations and governmental agencies.

Opinion

Because of the life interest retained by the decedent, it is not disputed that the corpus of each trust was properly includable in the decedent's gross estate under Section 2036.

The sole question herein is whether the discretionary authority given the corporate trustee by the governing instruments (i.e., to allocate receipts and expenditures between principal and income and to invest in wasting assets without provision for a reserve or sinking fund) precludes the deductibility under Section 2055(a)(2)[15] of the otherwise undisputed value of the remainder interests in favor of concededly charitable organizations. Neither the efforts of the parties nor our own research has disclosed a case in which this precise question has been determined.[16]

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15. Sec. 2055. Transfers for Public, Charitable, and Regligious Uses.

(a) In General. - For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers . . . .

* * *

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes . . . .

16. We consider Colt v. Duggan, 25 F. Supp. 268 (S.D.N.Y. 1938), distinguishable. That case involved an income tax charitable deduction pursuant to sections 162(a) and 23(n) of the Revenue Act of 1932. In addition to the discretionary powers of allocation, the trustee also had a power directly to invade corpus for the benefit of the non-charitable income beneficiaries. The charitable remainder interests were consequently held non-deductible.

Opinion

Respondent's position is that the discretionary powers thus conferred upon the trustee were totally unrestricted and that, even if local law imposed some limitation on the free exercise of those powers, the applicable standard of conduct was not sufficiently strict and definite. He therefore asserts that they constituted a power of invasion, albeit indirect, which could be used to augment the income of the life beneficiaries. Accordingly, respondent concludes that the charitable remainders were not "presently ascertainable and hence severable," as required by Section 20.2055-2(a), Estate Tax Regulations, and that the possibility that the charitable transfers would not become effective was not "so remote as to be negligible," as required by Section 20.2055-2(b), Estate Tax Regulations.[17]

17. Section 20.2055-2. Transfers not exclusively for charitable purposes.

(a) Remainders and similar interests. If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

* * *

(b) Transfers subject to a condition or a power. If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the

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Opinion

Previous cases have dealt with the impact of discretionary trustee powers of direct invasion of trust corpora for the benefit of noncharitable beneficiaries and have seemingly constructed dual and mutually exclusive tests based upon the "presently ascertainable" and "so remote as to be negligible" standards of respondent's regulations. Cf. Commissioner v. Sternberger's Estate, 348 U.S. 187 (1955); Hamilton National Bank of Chattanooga v. United States, 236 F. Supp. 1005 (E.D. Tenn.), affirmed per curiam 367 F.2d 554 (C.A. 6, 1966). Compare, e.g., United States v. Commercial National Bank of Kansas City, 404 F.2d 927 (C.A. 10, 1968); Salisbury v. United States, 317 F.2d 700 (C.A. 2, 1967); Estate of Russell Harrison Varian, 47 T.C. 34, 48 (1966), affirmed per curiam 396 F.2d 753 (C.A. 9, 1968). We see no need to delve into the esoterisms involved in drawing distinctions between these two standards. See Taggart, "Charitable Deductions for Transfers of Remainder Interests Subject to Invasion," 21 Tax L. Rev. 535 (1966). As we see it, the critical question is whether the discretionary powers conferred upon the corporate trustee herein constituted a power of indirect invasion

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deduction is allowable. If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power. (Emphasis added.)

* * *

as respondent contends. If that question is answered in the negative, then it would seem that each standard set forth in respondent's regulations will have been met since, aside from the existence of the discretionary powers, the remainder shares are clearly "ascertainable and hence severable" and the governing instruments create no other potentially impairing contingencies.

Both parties agree that the scope of the discretionary powers herein should be determined under New York law and have cited numerous decisions of the New York courts to support their positions. Respondent asserts that the broad powers of the trustee are at most subject to judicial interference only in the event of an arbitrary exercise thereof. Petitioner, on the other hand, claims that the trustee would be required both to act in good faith and to exercise reasonable judgment within the scope of the plan and intention of the settlor. We see no useful purpose to be served by a detailed exposition of the New York decisions, since each case dealing with the interpretation of a trustee's powers ultimately turns upon its own particular facts and is therefore distinguishable. We have concluded that petitioner's analysis is the correct one.

It is clear that the grant of discretion to a trustee, however broad, does not "relieve him from obedience to the great principles of equity which are the life of every trust." Carrier v. Carrier, 226 N.Y. 114, 123 N.E. 135, 138 (1919). Discretionary power given to a trustee to invest

in non-legals must still be exercised prudently. Matter of Bruen's Estate, 83 N.Y.S. 2d 197 (Surr. Ct. N.Y. Co. 1948); Matter of City Bank Farmers Trust Co., 189 Misc. 942, 68 N.Y.S. 2d 43 (Sup. Ct. N.Y. Co. 1947); Matter of Clark's Will, 165 Misc. 801, 1 N.Y.S. 2d 629 (Surr. Ct. Kings Co. 1938); Matter of Albro's Will, 165 Misc. 486, 300 N.Y.S. 1103 (Surr. Ct. Westchester Co. 1937). A trustee has a duty of equal loyalty to all beneficiaries. Matter of Dickson's Estate, 38 Misc. 2d 678, 237 N.Y.S. 2d 572 (Surr. Ct. N.Y. Co. 1963); Matter of Heinrich, 195 Misc. 803, 90 N.Y.S. 2d 875 (Surr. Ct. Monroe Co. 1949). As the court noted in Matter of Woodin's Estate, 118 N.Y.S. 2d 465, 469 (Surr. Ct. N.Y. Co. 1952), in summarizing the duties of a trustee:

> It is beyond dispute that the testamentary trustees owe equal duties to the income beneficiaries and the remaindermen. One obligation to the remaindermen is to safeguard the trust corpus but no obligation is owed to incur speculative risks to increase the corpus. [18] An obligation to the income

18. Compare New York Estates, Powers and Trusts Law (McKinney's), section 11-2.1(a), effective September 1, 1967, which states that "[a] trust shall be administered with due regard to the respective interests of income beneficiaries and remaindermen" and requires that, in situations not covered by the "terms of the trust instrument" or "the provisions of this section," receipts and expenditures shall be allocated "in accordance with what is reasonable and equitable in view of the interests of those entitled to income as well as those entitled to principal and in view of the manner in which men of ordinary prudence, discretion and judgment would act in the management of their own affairs."

> beneficiaries is to maintain the trust funds in investments that are productive of income. [5]

See also Blodget v. Delaney, 201 F.2d 589, 593-594 (C.A. 1, 1953).

The thrust of New York law is further reflected in a statutory provision declaring void any provision exonerating a fiduciary "from liability for failure to exercise reasonable care, diligence, and prudence." See New York Estates, Powers and Trusts Law (McKinney's), Section 11-1.7(a)(1), incorporating identical language previously contained in New York Decedent Estate Law (McKinney's), Section 125.

The New York cases relied upon by respondent are all distinguishable on their facts. Many of them involved the right of a trustee to invade corpus in light of the demonstrated concern of the settlor for the income beneficiary, a factor not present herein. The emphasis in some of the opinions upon a standard of arbitrariness as the measure of a trustee's responsibility occurred in the context of factual situations where the trustee was held liable for having acted arbitrarily, and thus was directed toward the negative proposition of imposing an outer limit of responsibility rather than a positive standard of conduct. The decedent herein provided, in one of the trust instruments, that the trustee might, during the term of her reserved life estate, invade the whole of the corpus opus for her "support, care, comfort and well being." No such provision appears in the other trust instrument, in which the decedent also re-

served a life estate. Nor does any such provision appear for the benefit of decedent's sister and brother-in-law, who became the income beneficiaries at decedent's death. Such a clear indication of the decedent's knowledge and use of a power of direct invasion bears heavily against interpreting discretionary powers of administration in the trustee as creating a power of indirect invasion for the benefit of the income beneficiaries, especially since there is no indication whatsoever of any intent on the part of the decedent to favor such beneficiaries at the expense of the charitable remaindermen.

We think it also significant that, at all times between the establishment of the trusts and the decedent's death, the assets of the trusts consisted entirely of small amounts of cash and publicly traded stocks and debt obligations of well-known business corporations and governmental agencies. Thus, we need not concern ourselves with situations where at the date of death there was an actual or indicated pattern of investment in wasting assets or securities involving capital gains distributions (e.g., regulated investment companies) and we specifically abjure expressing any opinion in respect thereto. Compare Rev. Rul. 67-33, 1967-1 C.B. 62, supplementing Rev. Rul. 60-385, 1960-2 C.B. 77; Rev. Rul. 60-162, 1960-1 C.B. 376.[19]

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19. We note also that Rev. Rul. 65-144, 1965-1 C.B. 442, indicates, without discussion, that a general power to apportion receipts between income and principal precludes a deduction for a charitable remainder under section 25.2522 (a)-2, Gift Tax Regulations, the provisions of which are sub-

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Finally, we note that an independent third party, i.e., a bank, was named sole trustee and that the governing instruments herein expressly imposed upon the trustee a "duty to act in good faith and with reasonable care." The presence or absence of such a provision has been a critical factor in determining whether a trust in which the decedent-settlor-trustee has broad discretionary powers should be included in the gross estate under Section 2036 or Section 2038. Compare Estate of Ralph Budd, 49 T.C. 468, 475-476 (1968), and Estate of Marvin L. Pardee, 49 T.C. 140, 146, 147 (1967), in which State Street Trust Company v. United States, 263 F.2d 635 (C.A. 1, 1959), heavily relied upon by respondent herein, is distinguished. We recognize that the comparability of trust powers may differ for the purposes of Sections 2036 or 2038 as opposed to Section 2055, but the thrust of the foregoing decisions is not without significance in arriving at a decision herein.

It cannot be gainsaid that in theory the trustee herein might use its discretionary powers to allocate to income amounts that might, as an a priori matter, be technically allocable to corpus,

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stantially identical to those contained in section 20.2055-2, Estate Tax Regulations, involved herein. Aside from the fact that such ruling is not binding upon us, the ruling essentially turned on a holding that a conditional power of revocation was against public policy and that therefore the imposition of the gift tax could not be avoided. See Taggart, "Charitable Deductions for Transfers of Remainder Interests Subject to Invasion," 21 Tax L. Rev. 535, 571, n. 65 (1966).

and thereby impair the charitable remainders. But such theoretical possibility is not determinative. As Mr. Justice Holmes observed in Ithaca Trust Co. v. United States, 279 U.S. 151 (1929), which held that the possibility of exercise of a power of invasion in favor of an income beneficiary did not preclude the deduction of a charitable remainder for estate tax purposes, "[t]here was no uncertainty appreciably greater than the general uncertainty that attends human affairs." See 279 U.S. at p. 154. We think that the same principle applies to the instant case. All trusts are subject to the vicissitudes of the economy as well as depletion through unwise, if not imprudent or unreasonable, decisions on the part of the trustees. As a consequence, a comparison of the present remainder interests with those of a trust where the trustee does not have such discretionary powers is not one of uncertainty versus certainty, but rather a comparison between degrees of uncertainty.

Cases of this type inevitably involve the difficult task of line drawing — a task which requires the placing of a particular case on one side of the line or the other, based upon an analysis of all the facts. See United States v. Dean, 224 F.2d 26, 29 (C.A. 1, 1955); Estate of Mary Cotton Wood, 39 T.C. 919, 924 (1963).

Under all the circumstances herein, we think there was no more likelihood that the corporate trustee would or could, in light of New York law, utilize its discretionary powers as a substitute power of invasion for the benefit of the income

beneficiaries than there would be in a situation where such provisions were not included in the governing instruments. Cf. William T. Grant, 48 T.C. 606, 629 (1967). Compare Rev. Rul. 69-344, I.R.B. 1969-25, 21, and Rev. Rul. 66-39, 1966-1 C.B. 223, where respondent seems to adopt a more liberal approach than the one advocated by him herein. To hold otherwise would be to turn what are commonplace trust powers intended simply to provide administrative flexibility into a substantive grant of dispositive flexibility. Compare In Re Arens, 41 N.J. 364, 197 A.2d 1 (1963); see Scott, "Principal or Income?", 100 Trusts and Estates 180, 251 (1961); Note, 61 Northwestern L. Rev. 640, 644-650 (1966). This we are not prepared to do.

We conclude, and we so find, that the charitable remainders were "presently ascertainable" and that the possibility that they would not take effect was "so remote as to be negligible." The claimed deduction should be allowed under Section 2055.

To reflect the other agreements of the parties,

Decision will be entered under Rule 50.

Reviewed by the Court.

Decision

TAX COURT OF THE UNITED STATES

(Same Title)

Pursuant to the opinion of the Court filed August 14, 1969, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there is an overpayment in estate tax in the amount of $351.09, which amount was paid on August 20, 1965, and for which amount a claim for refund could have been filed, under the provisions of section 6511 (b)(2) of the Internal Revenue Code of 1954, on November 14, 1967, the date of the mailing of the notice of deficiency.

(Signed) THEODORE TANNENWALD, JR.

Judge.

Entered: NOV 26 1969

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APPENDIX D

Statute

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 2055. Transfers for Public, Charitable, and Religious Uses.

(a) In General.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers (including the interest which falls into any such bequest, legacy, devise, or transfer as a result of an irrevocable disclaimer of a bequest, legacy, devise, transfer or power, if the disclaimer is made before the date prescribed for the filing of the estate tax return)—

* * *

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation;

* * *

Regulations

Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.):

§20.2055-2 Transfers not exclusively for charitable purposes.

(a) Remainders and similar interests. If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest. The payment value of a remainder table purpose is to be determined in accordance or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in §20.2031-7. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. To determine the present value of such remainder use the appropriate factor from column 4 of Table I or Table II of §20.2031-7, whichever is applicable. If the interest transferred is such that its value is to be determined by a special computation (see paragraph (e) of §20.2031.7), a request for a specific factor, accompanied by a statement of the date of birth of each person the duration of whose life may affect the value of the remainder, and by copies of the

relevant instruments, may be submitted by the executor to the Commissioner, who may, if conditions permit, supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraph §20.2031-7.

(b) Transfers subject to a condition or a power. If, as of the date of decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the deduction is allowable. If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole, or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or

fund which is exempt from an exercise of the power. The deduction is not allowed in the case of a transfer in trust conveying to charity a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For example, assume that assets placed in trust by the decedent consist of stock in a corporation the fiscal policies of which are controlled by the decedent and his family, that the trustees and remaindermen are likewise members of the decedent's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances no deduction will be allowed. Similarly, if the trustees are not members of the decedent's family but have no power to sell or otherwise dispose of the closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization, no deduction will be allowed.

* * *

CERTIFICATE OF SERVICE

I, EDWIN M. DOTTEN, JR., Counsel for Petitioner herein, hereby certifies that on the day of June, 1971, I served four copies of the within Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit on the Respondent herein, the United States of America, by mailing the same postage prepaid to The Solicitor General, Department of Justice, Washington, D. C. 20530.

s/ Edwin M. Dotten, Jr.
Attorney for Petitioner